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No. 82-716

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF *AMICUS CURIAE* OF THE AMERICAN PETROLEUM INSTITUTE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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The American Petroleum Institute ("API") submits this brief *amicus curiae* in support of the petition for writ of certiorari filed by The El Paso Company.[1] API supports this Court's review of both questions presented by the petition; *viz.*,

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[1] Petitioner and respondent have given their written consent to the filing of this brief *amicus curiae*. Copies of those consents have been lodged with the clerk.

whether the court below erred in holding, contrary to decisions of other Circuit Courts, that a company's "tax pool analysis" is relevant under 26 U.S.C. § 7602 to an Internal Revenue Service investigation of the company's tax returns, even though the analysis was not used in preparing the returns, consists exclusively of speculation and opinion concerning potential tax issues, negotiations, and litigation the company may face, and was developed for purposes of assessing and reporting the company's contingent tax liability as required by the federal securities laws; and

whether the court below erred in holding, contrary to decisions in other Circuit Courts, that a company's tax pool analysis and its discussions relating thereto are not privileged, under either the attorney-client privilege or a work-product doctrine, even though the analysis was prepared by and in consultation with the company's attorneys and was confidentially discussed with its independent auditors for purposes of complying with the securities laws.

INTEREST OF THE AMICUS CURIAE

The American Petroleum Institute ("API") is a trade association consisting of approximately 330 member corporations and 8,000 individual members. API's members are engaged in all facets of the petroleum industry, including the production, refining, and marketing of crude oil and refined petroleum products.

The vital interest of API in this case is that of taxpayers who are or could be similarly situated to the petitioner in this case. Member corporations include publicly held corporations or subsidiaries of publicly held corporations subject to federal securities laws. Members of the API are subject to jurisdiction in each of the circuits of the courts of appeal which have rendered inconsistent decisions regarding the scope of 26 U.S.C. § 7602 and this Court's decision in *United States v. Powell*, 379 U.S. 48 (1964). In this case the Internal Revenue Service

("IRS") sought to enforce a summons seeking production of what is often referred to as tax pool analysis, non-current tax account, or tax accrual workpapers.

The divided court of appeals held that in this case, a routine investigation not involving an allegation or suspicion of fraud, the IRS may compel, through a summons enforcement proceeding, production of "tax pool analysis" and any memoranda used to prepare the analysis. *United States v. El Paso Co.*, 682 F.2d 530, 545 (5th Cir. 1982). In so doing, the court of appeals held, contrary to the Tenth Circuit's decision in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), that the tax pool analysis and supporting memoranda, although not used in the preparation of a return and containing opinions, forecasts and judgments of the taxpayer made pursuant to requirements of the federal securities laws, were "relevant" within the meaning of 26 U.S.C. § 7602. *El Paso*, 682 F.2d at 537-38. Further, the court of appeals held that the tax pool analysis was not privileged under either the attorney-client privilege or work product doctrine, thereby again producing a conflict with other courts of appeals. *Id.* at 542.

In addition to being subject to inconsistent views of several courts of appeal, the subject of petitioner's writ of certiorari in this case raises important questions of the administration of federal tax and securities laws as well as the continued vitality of this Courts' opinion in *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

REASONS FOR GRANTING THE WRIT

A decision to grant the petition for certiorari in this case will resolve conflicts existing in the courts of appeal and provide guidance to taxpayers consistent with this Court's construction of 26 U.S.C. § 7602 in *United States v. Powell*, 379 U.S. 48 (1964). It will enable this Court to prevent the erosion of its decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981). It will allow this

Court to reaffirm the congressional policy underlying the federal securities laws and avoid undue interference with that policy by administrative interpretations of the internal revenue laws in the absence of congressional intent to do so and, inferentially, in the face of much more limited and precise action by Congress.

I. RELEVANCE

Public companies subject to the federal securities laws must file financial statements that have been examined in accordance with generally accepted auditing standards. *See* 15 U.S.C. § 81(l) and (m), Regulation S-X, 17 C.F.R. § 210.1-.12-29 (1981). Companies subject to the federal securities laws must prepare or have prepared by their independent public auditors an analysis of their contingent tax liabilities in order to comply with the federal securities laws.

Whether prepared by the taxpayer or its independent public auditors, the positions taken by a taxpayer on its return are discussed with the independent public auditor. These confidential discussions, which are incident to the work resulting in the estimation of a taxpayer's potential exposure, are indispensable to the independent audit process. The independent audit process is designed to insure that the taxpayer's financial statements meet the required federal securities laws standards. In this process, potential results are often explored on a hypothetical worst-case basis. The memoranda supporting the tax pool analysis reflect the mental processes of the taxpayer. They often analyze potential results of transactions based on current or possible case law and legislation as well as current and possible IRS positions or reactions. The taxpayer's inquiry is not limited to positions taken with respect to a federal tax return. Many corporations consider items of significant exposure in the other jurisdictions, including foreign jurisdictions. *Cf. United States v. Coopers & Lybrand*, 413 F. Supp. 942, 951 (D. Col.

1975). The resulting tax pool analysis or tax accrual workpapers "contain the taxpayer's evaluation of its exposure to liability for additional income taxes; they pinpoint the precise tax issues of concern to the taxpayer—issues which may be vulnerable to IRS attack; and they reflect, on an item-by-item basis, the taxpayer's careful estimate of its likelihood of prevailing in the event of controversy. In short, they provide the IRS examining officer with a definitive roadmap to the soft spots in the tax return." Caplin, *IRS Toughens Its Stance on Summoning Accountants' Tax Accrual Workpapers*, 53 J. Tax. 130, 130 (1980).

In *El Paso*, the court below refused to hold that the analyses in question were not the proper subject of a summons within the scope of 26 U.S.C. § 7602. 682 F.2d at 537. The standard used by the Fifth Circuit in determining that the analyses in question may be relevant in ascertaining the correctness of the taxpayer's return was "whether the summons seeks information which "might throw light upon the correctness of the taxpayer's return,"," *Id.* (citing *United States v. Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981) and *United States v. Noall*, 587 F.2d 123, 125 (2d Cir. 1978), *cert. denied*, 441 U.S. 923 (1979)).

A similar view was expressed by the Second Circuit, in the case of *United States v. Arthur Young & Co.*, 677 F.2d 211, 218 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (Oct. 20, 1982) (No. 82-687), which denied enforcement of a summons issued to an independent public accounting firm on other grounds, discussed below. The Solicitor General filed a petition for writ of certiorari in *United States v. Arthur Young*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (October 20, 1982) (No. 82-687).

The holdings of the Fifth and Second Circuits are in direct conflict with the holding in the Tenth Circuit in *United States v. Coopers & Lybrand Co.*, 550 F.2d 615

(10th Cir. 1977). There the IRS sought to compel production of a tax pool analysis held by the independent public auditor and not the taxpayer. *Id.* at 617. There, as in this case, it was uncontested that the independent public auditor had no responsibility for the preparation or review of the taxpayer's income tax returns and that the tax pool analysis was not prepared in connection with the preparation and filing of the taxpayer's return. *Id.* There the taxpayer created a tax pool analysis file for its use in preparing its annual consolidated financial statements and it was utilized by the independent public auditor in verifying, in accordance with federal securities laws, that the financial statements complied with generally accepted accounting principles. *Id.* at 618. There, as here, the IRS did " 'not seek records of corporate transactions or the data which are customarily maintained in support of company transactions, instead it seeks private thoughts and theories of the taxpayer.' " *Id.* Although recognizing the broad investigative powers conferred on the IRS by 26 U.S.C. § 7602, the court noted that such powers are not without limitation and held that the summons issued by the IRS was unenforceable. 550 F.2d at 619, 621.

The holdings of the Fifth and Second Circuits are also in conflict with the Eighth Circuit's decision in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973). In that case, cited by this Court in *United States v. Bisceglia*, 420 U.S. 141 (1975), as an appropriate application of the standards of *United States v. Powell*, 379 U.S. 48 (1964), the Eighth Circuit held unenforceable an IRS summons of the taxpayer's budget proposals for years under examination. *United States v. Matras*, 487 F.2d at 1275. The Court rejected the IRS's contention of a general need for a "road map" to the taxpayer's tax returns and affirmed the district court holding that records of actual transactions and not budgets are relevant to a determination of the taxpayer's liability. *Id.*

In each of the above cases the Service sought production of analyses by the taxpayer or its independent auditor to gain access not to *factual* information respecting the taxpayer's tax liability or the correctness of its return but, rather, to the taxpayer's analyses and thought processes.[2] Although the taxpayer's theories and opinions regarding positions taken on its tax return may be convenient for the IRS in conducting an examination of the taxpayer's return, *convenience* does not equate to *relevance*. *Coopers & Lybrand*, 550 F.2d at 621; *Matras*, 487 F.2d at 1275.

The standard of relevance pressed for by the respondent in this case that the analyses in question might shed some light upon the taxpayer's return is overbroad. Publicly held corporations often have tax departments comprised of attorneys and accountants; tax premises are built into economic evaluations and forecasts prepared by a corporation. When pressed to its logical limit, the conception of relevance adopted by the court below has no limitations at all. *Cf. Matras*, 487 F.2d at 1275.

Enforcing the summons issued in this case, where no allegation of fraud or negligence exists, will impede the proper function of corporate tax departments. The

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[2] As Judge Garwood pointed out in his dissent below, the context in which the word "relevant" appears in the statutory provision in question enhances the propriety of the construction that it relates to factual materials. *United States v. El Paso Co.*, 682 F.2d at 548 (Garwood, J., dissenting). Section 7602 refers to "books, papers, records and other data." These terms are commonly thought to refer to factual materials. The word "data" is defined as "things known or assumed; *facts or figures from which conclusions can be inferred*; information." *Webster's New Twentieth Century Dictionary* (2d ed. 1979) (emphasis added). Here the respondent seeks not factual materials from which conclusions can be inferred but the conclusions themselves. *See also* Caplin, *Should the Service Be Permitted to Reach Accountants' Tax Accrual Workpapers?*, 51 J. Tax. 194, 199-200 (1979); Caplin, *Government Access To Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax. Rev. 57, 68 (1981).

standard adopted would apply not only to analyses and opinions generated in connection with the preparation of financial statements in compliance with federal securities laws but to virtually any document generated by the corporate tax department, and possibly the entire corporation. API submits that this will greatly impede the conduct of business by its member corporations and do away with the standards fashioned by this Court in *United States v. Powell*, 379 U.S. 48 (1964). It will inhibit the free flow of advice emanating from corporate tax departments and undermine the quality and depth of such advice. The policies underlying the self-assessment system, consistent with the policies of the federal securities laws, should encourage, rather than restrict, critical analysis of issues arising under the tax code by corporate tax departments.

II. ATTORNEY-CLIENT PRIVILEGE

This Court in *Upjohn Co. v. United States*, 499 U.S. 383 (1981), settled the question that the attorney-client privilege and the work-product doctrine apply to protect information from compulsory disclosure in a tax summons enforcement proceeding. In *El Paso* the court apparently held that limited disclosure of some of the information and many of the potential tax liability issues constituted a waiver of the attorney-client privilege with respect to the entire compilation of opinions and analyses forming a part of the tax pool analysis. *See* 682 F.2d at 541.

The Fifth Circuit recognized in *El Paso* that corporations must prepare or have prepared for them by their independent auditors an analysis of their contingent tax liabilities in order to comply with the federal securities laws. 682 F.2d at 534. The potential issues must of necessity be discussed between the taxpayer and its independent auditor in order to comply with the federal securities laws. *Id.* The Fifth Circuit further recognized that an analysis of the soft spots on a tax return by an

attorney and his judgment on the outcome of litigation on it were legal advice. *Id.* at 539. To hold that discussion of the potential tax liability issues with the taxpayer's independent public auditor in order to comply with federal securities laws constitutes a waiver of the attorney-client privilege as to all supporting opinions and memoranda, *see* 682 F.2d at 550 n. 14, even though not disclosed, seriously erodes the doctrine recently reaffirmed by this Court in *Upjohn Co. v. United States*, 499 U.S. 383 (1981).

Discussions with the independent auditor are confidential in nature and are unrelated to the filling out of a tax return. Thus, unlike the situation in *Couch v. United States*, 409 U.S. 322 (1973), there is some expectation of privacy on the part of the taxpayer. *El Paso*, 682 F.2d at 539. Judge Garwood, in his dissent below, aptly pointed out that "the reality of the matter is that for publicly held companies very little information can properly be held entirely confidential from independent auditors." *Id.* at 551 (Garwood, J., dissenting). This fact, ignored by the court below, must be accounted for in fashioning rules regarding waiver of the attorney-client privilege. For example, if the ruling of the court below is upheld, then on facts identical to those of *Upjohn Co. v. United States*, discussion by Upjohn of potential tax issues arising from the investigation in that case with its independent public auditors for purposes of determining whether any amount should be included in Upjohn's tax contingency liability in its financial statements would presumably result in a waiver of the attorney-client privilege with respect to all materials protected under that case.

API urges this Court to reverse this holding of the Fifth Circuit because it injects uncertainty into an important area of federal tax law by eroding this Court's opinion in *Upjohn* and because it conflicts with the law in other Circuits. *See Diversified Industries, Inc. v. Mer-*

edith, 572 F.2d 596 (8th Cir. 1977) (*en banc*); *United States v. Upjohn Co.*, 600 F.2d 1223, 1227 n. 12 (1979); *Weil v. Investment/Indicators, Research & Management*, 647 F.2d 18, 25 (9th Cir. 1981).

III. WORK PRODUCT DOCTRINE

1. The Fifth Circuit created a conflict with the Second Circuit's decision in *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), by refusing to recognize the need for a work-product privilege for the materials at issue in this case. As noted earlier, in *Arthur Young* the Second Circuit held unenforceable a summons issued to the taxpayer's independent public auditor to produce a tax pool analysis prepared by the taxpayer's independent public auditor. *Id.* at 220. The court weighed the importance of the procedure designed by Congress by its enactment of the federal securities laws to protect the investing public from inaccurate financial information against the argument of the IRS in support of its desire "to summon a roadmap of the thoughts and theories of a taxpayer and its independent public auditor." *Id.* The court held that where the IRS is not attempting to prove fraud, the paramount need of the investing public in accurate financial information required it to fashion a work-product privilege to protect the independent auditing process. *Id.* at 221. *Cf. Donaldson v. United States*, 400 U.S. 517, 530 (1971) (where this Court observed that the materials at issue there were not the work-product of the taxpayer's attorney or his accountant, thereby preserving the issue for the future). The considerations weighed by the Second Circuit in holding the summons in *Arthur Young* unenforceable apply with undiminished force to the taxpayer. The "independent auditing process" sought to be protected is one in which both the taxpayer and its independent auditor partake. Indeed, the failure to apply the *Arthur Young* rationale to materials prepared by the taxpayer in this case would defeat its purpose.

The *Arthur Young* holding shields the independent auditor from tax summons enforcement proceedings under the work-product privilege fashioned in that case. However, the holding in *El Paso* would require the taxpayer to produce the tax pool analysis or to testify as to its contents. Moreover, the taxpayer would not be protected where the same analysis was performed by the taxpayer instead of the independent auditor, even though the materials are prepared by an attorney. API believes that the policy underlying the federal securities laws requires that the analysis of the potential tax liability of a taxpayer extend equally to the independent public auditor and the taxpayer, whether prepared by the independent auditor, the taxpayer or both in conjunction. The subject matter and the analysis are the same, regardless of by whom it is prepared.

2. The court below held that analyses prepared by the attorneys for the Petitioner did not constitute "work product" under the doctrine first set forth in *Hickman v. Taylor*, 329 U.S. 495 (1947). The Fifth Circuit recognized that the analysis by an attorney of the soft spots in a tax return on the outcome of litigation on it are legal advice but did not recognize that they were being assembled and brought into being in anticipation of litigation. *El Paso*, 682 F.2d at 543. API submits that this ruling miscontrues the nature of the tax accrual analysis. The tax liability contingency in the financial statements is generated precisely because of the likelihood of challenge by the Government and subsequent litigation. The analysis identifies which issues are likely to be the subject of litigation and then makes an educated guess on the likely outcome. If the IRS was not expected to challenge the taxpayer's return, there would be no need for the tax contingency. In *Upjohn v. United States*, this Court recognized that materials prepared "to supply a basis for legal advice concerning compliance with securities and tax laws . . . and potential litigation in each of these areas . . ." were within the work-product doc-

trine. 449 U.S. at 394. The failure of the court below in *El Paso* to recognize that the materials in question were subject to the work-product doctrine conflicts with *Upjohn*.

3. Aside from the important issue raised regarding the scope of the work-product doctrine in the context of the tax pool analysis, the holding by the Court that the work-product doctrine does not apply because outside counsel "handled" litigation and the corporate counsel acted only as co-counsel in litigation, raises a question of federal law of importance beyond the tax issues present in this case which this Court should address. Holding that materials prepared in anticipation of litigation are not covered under the work-product doctrine simply because they are prepared by corporate counsel not taking the lead in litigation ignores the reality of the way business is done today by a great number of corporations and law firms. Further, in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), all the materials at issue were prepared by corporate counsel and the decision gives no indication that any weight is to be accorded to whether corporate counsel takes the lead in litigation or not. The opinion of the court below injects considerable uncertainty into what, up to now, was considered by most a settled area of law. API urges this Court to reject the novel position taken by the court below.

IV. POLICY

The importance of the issues raised in this case to the administration of the federal tax and securities laws is not disputed.[3] The interest of the IRS in effective en-

[3] The First Circuit noted the need for critical analysis and guidance in this area of law. The court stated: "The importance of the interests of all concerned—taxpayers, accountants and IRS—is clear. That a resolution sensitively reflecting the legitimate interests of all and faithful to applicable statutes would involve the most delicate and demanding analysis of facts, research of law and reflection on

forcement of the tax code, embodied in 26 U.S.C. § 7602, is not without limits. This Court has stated that the summons authority claimed should be "*necessary* for the effective performance of congressionally imposed responsibilities to enforce the tax code . . ." and that the summons authority should be weighed against "express prohibition or *substantial countervailing policies.*" *United States, et al. v. Euge*, 444 U.S. 707, 711 (1980) (emphasis added).

API submits that the summons authority sought here is not *necessary* for the effective enforcement of the tax code and that it is in derogation of countervailing policies enunciated by Congress. As noted earlier and as stated by the Second Circuit, "so long as a case does not involve allegation of fraud, the Service does not need to know taxpayer's thoughts." *Arthur Young*, 677 F.2d at 220. API does not understand the respondent in this case to say that the audit could not be completed without the tax pool analysis. Convenience, not necessity, is the Government's objective.

Substantial countervailing policies are at work here. Firstly, the congressional objective of securing for the investing public accurate financial information is apparent. The taxpayer and its independent auditor *must* undertake a tax pool analysis to comply with SEC financial reporting requirements. Making the tax pool analysis subject to the IRS's summons authority in the absence of fraud allegations will inhibit the independent auditing practice. Taxpayers will be wary of disclosing confidential information about their thoughts and theories regarding tax positions to their independent public auditor if this becomes an effective disclosure of the same information to the IRS. The depth and quality of the tax pool analysis would in-

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policy is equally clear." *United States v. Arthur Andersen & Co.*, 623 F.2d 725, 729 (1st Cir. 1980); *see also United States v. Arthur Andersen & Co.*, 623 F.2d 720 (1st Cir. 1980).

evitably suffer. *Cf. Upjohn Co. v. United States*, 449 U.S. at 393 n. 2; *Arthur Young*, 677 F.2d at 220 n. 9.

Secondly, the requirement in *United States v. Euge*, 444 U.S. 707 (1980), that the summons authority claimed to be necessary for enforcement of the tax code could itself be viewed as an expression of the congressional policy set forth in 26 U.S.C. § 7605(b) that taxpayers not be subject to unnecessary examination investigation.

Thirdly, the adverse impact on the self-assessment system of taxation of allowing the IRS to delve into the mind of the taxpayer by obtaining the tax pool analysis was noted by former IRS Commissioner Caplin. *See* Caplin, *supra*, 1 Va. Tax. Rev. at 82. The Second Circuit in *Arthur Young* also noted that requiring the taxpayer alone to disclose settlement positions contained in a tax pool analysis would improperly weigh the balance presently existing between collecting revenue and conserving judicial resources. 677 F.2d at 220. API submits that these policies should be considered by this Court in reviewing the petition in the instant case.

Fourthly, the unwarranted attempt by the IRS to reach these materials under 26 U.S.C. § 7602, a longstanding statute, is more appropriately left to Congress. The Second Circuit, in *Arthur Young*, in concluding that the summons in that case should not be enforced, stated:

> In reaching this conclusion, we are comforted by the knowledge that if Congress feels that this privilege unduly restricts the IRS' authority, it can require that this material will be made available, or that taxpayer's flag their questionable positions directly on their returns in line with the suggestions of Former Commissioner Kurtz [citation omitted]. Procuring tax accrual workpapers under Section 7602 seems to us to effectuate Commissioner Kurtz's proposal through the back door.

677 F.2d at 221.

Congress has indeed acted with much more precision than the IRS in this case. *See* Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 323 1982 U.S. Code Cong. & Ad. News (96 Stat.) 324. Congress has seen fit to require taxpayers to disclose on their returns positions which lack substantial authority or to face the consequences of underpayment penalties. The IRS's concern with delving into the mind of the taxpayer in this case was resolved by Congress in a much more limited and appropriate fashion.

Finally, the impact of this case on the policies expressed in *Upjohn* should be considered by this Court. Taxpayers should be free to discuss confidentially potential issues and exchange thoughts and theories with their professional advisors without fear that the IRS will subsequently gain access to such materials and testimony about them.

CONCLUSION

The petition for a writ of certiorari should be granted in this case to resolve the conflict in the courts of appeal and provide needed guidance to the lower courts and taxpayers on the important and recurring questions of federal law discussed above.

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